



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3A

THE INSOLVENCY SYSTEM OF THE UNITED STATES

This is the summative (formal) assessment for Module 3A of this course and is compulsory for all candidates who selected this module as one of their compulsory modules from Module 3. Please read instruction 6.1 on the next page very carefully.

If you selected this module as one of your elective modules, please read instruction 6.2 on the next page very carefully.

The mark awarded for this assessment will determine your final mark for Module 3A. ***In order to pass this module, you need to obtain a mark of 50% or more for this assessment.***

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. **You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.**
2. **All assessments must be submitted electronically in MS Word format, using a standard A4 size page and a 11-point Arial font. This document has been set up with these parameters - please do not change the document settings in any way. DO NOT submit your assessment in PDF format as it will be returned to you unmarked.**
3. **No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).**
4. **You must save this document using the following format: [studentID.assessment3A]. An example would be something along the following lines: 202223-336.assessment3A. Please also include the filename as a footer to each page of the assessment (this has been pre-populated for you, merely replace the words "student number" with the student number allocated to you). Do not include your name or any other identifying words in your file name. Assessments that do not comply with this instruction will be returned to candidates unmarked.**
5. **Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
- 6.1 **If you selected Module 3A as one of your compulsory modules (see the e-mail that was sent to you when your place on the course was confirmed), the final time and date for the submission of this assessment is 23:00 (11 pm) GMT on 1 March 2023. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2023. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.**
- 6.2 **If you selected Module 3A as one of your elective modules (see the e-mail that was sent to you when your place on the course was confirmed), you have a choice as to when you may submit this assessment. You may either submit the assessment by 23:00 (11 pm) GMT on 1 March 2023 or by 23:00 (11 pm) BST (GMT +1) on 31 July 2023. If you elect to submit by 1 March 2023, you may not**

submit the assessment again by 31 July 2023 (for example, in order to achieve a higher mark).

7. Prior to being populated with your answers, this assessment consists of 9 pages.

ANSWER ALL THE QUESTIONS

Commented [H(1): Total marks 44.75/50

QUESTION 1 (multiple-choice questions) [10 marks in total]

Commented [H(2): Total marks 9/10

Questions 1.1. - 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only ONE answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1

Commented [H(3): Correct, 1 mark

Which of the following entities does not satisfy the minimum presence requirement to be a debtor under any chapter of the Bankruptcy Code?

- (a) A foreign domiciled company that pays a US attorney a retainer.
- (b) A company with several US bank accounts, but no physical presence in the United States.
- (c) A company with US patents, but no physical presence in the United States.
- (d) All of the above satisfy the minimum requirement for presence in the United States.**
- (e) None of the above satisfy the minimum requirement for presence in the United States.

Question 1.2

Commented [H(4): Correct, 1 mark

ABC Corp is an industrial manufacturing company that is filing for bankruptcy. Which of the following could not be considered a party in interest?

- (a) A neighboring landowner to ABC Corp's manufacturing plant.
- (b) An environmental advocacy group that opposes ABC Corp's operations.**
- (c) The landlord of ABC Corp's corporate office.

- (d) *People who live several miles downstream from ABC Corp's manufacturing plant and have been exposed to the plant's toxic waste.*
- (e) *The US Internal Revenue Service.*

Question 1.3

Commented [H(5)]: Incorrect, the correct response is (a)

Which of the following contracts to which ABC Corp is a party is executory and may be assigned without counterparty consent?

- (a) *A lease on a manufacturing plant that contains a provision that requires landlord approval of any assignment.*
- (b) *An employment contract between ABC Corp and a former employee, requiring the company to provide health insurance through the end of the current year.*
- (c) *A 10-year software licensing agreement with XYZ Corp that is three years into performance.*
- (d) *A lease on office space that ended the prior year, but for which ABC Corp still owes past rent.*
- (e) *None of the above are executory and may be assigned without counterparty consent.*

Question 1.4

Commented [H(6)]: Correct, 1 mark

Which of the following conditions must be true about a reorganization plan for a court to confirm it under Chapter 11 proceedings?

- (a) *Have a possibility of success, even if it relies on speculative or improbable events to be capable of execution.*
- (b) *The plan is not likely to be followed by liquidation.*
- (c) *All impaired classes must accept the plan.*
- (d) *All of the above.*
- (e) *None of the above.*

Question 1.5

Commented [H(7)]: Correct, 1 mark

Which of the following about cramdowns, is false?

- (a) *The plan of reorganization must be fair and equitable to all impaired classes.*
- (b) *Differential treatment of different classes is permitted if there is a reasonable, good faith basis for doing so and such treatment is required for the plan of reorganization to be successful.*
- (c) *Class definition is often a battleground when a debtor tries to cramdown classes.*
- (d) *Dissenting creditors are permitted to challenge the classification of a creditor supporting the cramdown.*
- (e) *If one insider creditor approves of the plan of reorganization, all other impaired classes may be crammed down.*

Question 1.6

Commented [H(8)]: Correct, 1 mark

Which of the following about 363 sales is false?

- (a) *A good faith purchaser at a 363 sale may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal.*
- (b) *The debtor in possession must establish that the transaction is in the best interests of the estate as a whole.*
- (c) *In chapter 15 proceedings, a foreign court's approval alone suffices for a 363 sale.*
- (d) *Debtors must carry out a robust marketing process for the sale.*
- (e) *A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.*

Question 1.7

Commented [H(9)]: Correct, 1 mark

Which of the following is true of both an actual fraudulent conveyance and a constructive fraudulent conveyance?

- (a) *The debtor must have had an actual intent to hinder, delay, or defraud any entity to which the debtor was or became indebted.*
- (b) *Both require at least circumstantial evidence of the fraudulent intent.*
- (c) *The debtor must have been insolvent at the time of transaction.*
- (d) *In addition to provisions in the Bankruptcy Code, the debtor or the trustee may invoke applicable state or foreign fraudulent conveyance laws.*
- (e) *All of the above are true.*

Question 1.8

Commented [H(10)]: Correct, 1 mark

When does an automatic stay come into effect?

- (a) Immediately on the filing of any plenary petition.**
- (b) *On the filing of a voluntary petition but not on the filing of an involuntary petition.*
- (c) *Once the court reviews the petition and grants the stay.*
- (d) *Once the petitioner announces their intention to file for bankruptcy publicly.*
- (e) *Once a plan of reorganization is confirmed.*

Question 1.9

Commented [H(11)]: Correct, 1 mark

Which of the following regarding substantive consolidation is true?

- (a) *It respects the boundaries of corporate separateness.*
- (b) *It is the treatment of two or more creditors as a single creditor to simplify the claims process.*
- (c) If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation.**
- (d) *Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.*
- (e) *Authority for substantive consolidation comes from the Bankruptcy Code.*

Question 1.10

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Which of the following are relevant factors in determining a debtor's center of main interests (COMI) in the recognition stage of a Chapter 15 bankruptcy case?

- (a) *The location of the headquarters.*
- (b) *The location of primary assets.*
- (c) *The location of the majority of the affected creditors in the request for relief.*
- (d) *The jurisdiction whose law will apply to most disputes.*
- (e) All of the above.**

QUESTION 2 (direct questions) [10 marks]

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Question 2.1 (1 mark)

Commented [H(14)]: Total marks 1/1

What is setoff and why is it not permitted in many circumstances?

A setoff allows a creditor who holds a claim against a debtor and owes money to the same debtor to net the positions. Setoffs are not permitted in many circumstances as it improves the position of the sole creditor in comparison to the other unsecured creditors who are not owed money because it decreases their obligation to the estate by the full amount owed by the debtor as opposed to the lesser amount the debtor would pay on the unsecured claims.

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Commented [H(16)]: Correct, 1/2 mark

Question 2.2 [2 marks]

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What rules should you review when preparing a filing for a bankruptcy court?

When engaging in jurisdictions that one does not practice regularly, best practice would be to engage a local practitioner for advice on local practices. However, specifically when preparing a filing for a bankruptcy court one should review the Bankruptcy Rules, the Federal Rules of Civil Procedure, the local rules of the bankruptcy court and the respective judge's personal practices.

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Question 2.3 [2 marks]

What does the absolute priority rule require and when can it be deviated from?

The absolute priority rule requires that payment in full must be made to each category of claims before the next category receives anything. A deviation from the absolute priority rule is permitted under the chapter 11 plan with the consent of affected creditors. However, a deviation from the absolute priority rule is not permitted under chapter 7 where the statutory priorities must be strictly followed.

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Commented [H(24)]: Correct, 1/2 mark

Commented [H(25)]: Correct, 1/2 mark

Question 2.4 [2 marks]

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What is a "priming lien" and what requirements must be met for such a lien to be granted to secure DIP financing?

A priming lien is a senior to or equal to a pre-petition lien on estate property granted by the court to secure post-petition financing in the event financing cannot be obtained by any other terms. A priming lien will have priority in collateral over the pre-petition secured lenders. In order for a priming lien to be granted to secure DIP financing the debtor must demonstrate that the estate has unencumbered assets or encumbered asset with sufficient equity that the interest of the secured creditor being primed is adequately protected.

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Commented [H(28)]: Correct, 1/2 mark

Question 2.5 [3 marks]

What is a preference? What are the elements of a preference claim that need to be proved? Is a showing of fault, by either the debtor or creditor, required?

A preference is defined as a transfer of debtor's property made in a suspect period before the petition date that must be returned to the estate if it exceeds the amount the recipient would have received in a chapter 7 liquidation had the transfer not been made. While there is no need to show any fault of either the debtor or recipient of the preference payment there are elements of a preference claim that need to be proved, such as: a transfer of an interest of the debtor in property, to or for the benefit of a creditor, for or on account of an antecedent debt owed by the debtor before the transfer was made, the transfer was made while the debtor was insolvent, transfer made during the suspect period, and the transfer enabled the creditor to receive more than it would have in a chapter 7 liquidation.

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Commented [H(30): Correct, 1 mark

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QUESTION 3 (essay-type questions) [15 marks in total]

Question 3.1 [3 marks]

Describe the circumstances in which a bankruptcy court may enter a final order, who reviews appeals from bankruptcy court orders and how are non-final orders reviewed?

Bankruptcy courts were created by the 1978 Bankruptcy Code, as opposed to the US Constitution, with bankruptcy judges being appointed by the courts of appeal with limited tenure and limited jurisdiction to enter final orders. The bankruptcy court may enter a final order on core bankruptcy proceedings that do not invade Article III's jurisdiction (as seen in *Stern V Marshall*) such as matters concerning the administration of the estate, the allowance or disallowance of claims against the estate or exemptions from property of the estate and estimations of claims or interest under chapter 11-13, counterclaims by the estate against persons filing claims against the estate, orders in respect to obtaining credit, orders to turn over property of the estate and proceedings to determine, avoid, recover preferences, challenges to a petition or under the consent of the parties. Furthermore, appeals from bankruptcy court decisions are heard by the district court for the district in which they sit with bankruptcy appeals conversely being heard by a Bankruptcy Appellate Panel ("BAP"). To further clarify the standard of review applied, provided the ruling was in a core proceeding over which the bankruptcy court had authority to enter a final order, the district court or BAP reviews conclusions of law de novo and reviews findings of fact for abuse of discretion. However, in matters of noncore proceedings or non-final orders the district court or BAP reviews de novo all findings of fact and conclusions with their order being further reviewed by a circuit court of appeal de novo as to conclusions of law and for abuse of discretion for findings of fact.

Commented [H(35): Total marks 13.75/15

Commented [H(36): Total marks 2.75/3

Commented [H(37): Partially correct, 1/4 mark, resolution of counterclaims and some other core matters may invade Article III jurisdiction.

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Commented [H(39): Correct, 1/2 mark

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Question 3.2 [3 marks]

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What provisions of the Bankruptcy Code automatically apply to the debtor's property within the territorial jurisdiction of the United States upon recognition of a foreign main proceeding? What relief may be granted on a discretionary basis for either foreign main or non-main proceedings?

Foreign main proceedings are those that are commenced in the debtor's centre of main interests ("COMI"). The recognition requirements are that the foreign representative must establish that there is a pending foreign court or administrative proceedings regarding the debtor and that they are empowered to act by the proceedings. Upon the petition for recognition of a foreign main proceeding being granted there is an automatic invoke of a stay of creditor action, operation of the debtor's business in the ordinary course by the foreign representative, sale, transfer or use of property outside the ordinary course, and avoidance of post-petition transfers and perfection of security interest which are limited to the property of the debtor within the territorial jurisdiction of the United States or other interim assistance. The characterization of foreign proceedings as foreign main or foreign non-main determines the scope of the relief available to the debtor following recognition. While the aforementioned reliefs may be granted on a discretionary basis upon recognition of a foreign non-main proceeding, the following reliefs may also be granted on a discretionary basis following recognition of either foreign main or foreign non-main: authorization of discovery regarding the debtor's assets and affairs; entrusting administration of the debtor's US assets to the foreign representative or other person; extension of provisional relief, as well as any other relief necessary to ensure the function of Chapter 15 and protect the assets of the debtor and interests of creditors.

Question 3.3 [4 marks]

What duties do directors owe to a Delaware corporation in the ordinary course of business? To whom are these duties owed when the corporation is potentially or actually insolvent? What rule protects directors from liability for errors of judgment?

Directors owe a fiduciary duty of loyalty to a Delaware corporation's best interest and a duty of care in educated decision-making in the ordinary course of business, however, the directors are protected from liability for errors of judgement by the business judgement rule. Under the business judgement rule, the directors are presumed to have acted in good faith based on reasonable information with the only rebuttal coming when one can demonstrate most of the board were not reasonably informed, did not honestly believe their decision was in the best interest, or were not acting in good faith. During the period of potential or actual insolvency duties are owed to the corporation and its shareholders in the case of bankruptcy and therefore the shareholders will not receive anything in the bankruptcy. As confirmed by the Delaware Supreme Court, duties are never owed to creditors even in the event a corporation is operating in the zone of insolvency or actually insolvent.

Question 3.4 [5 marks]

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Commented [H(46)]: Correct, 1/2 mark

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List and describe the requirements that a creditor's claim must fulfill in order to qualify as a petitioning creditor in an involuntary proceeding.

A petitioning creditor is defined as one who successfully filed an involuntary petition. In order for a creditor to qualify as a petitioning creditor, they must have a claim against a debtor that is non-contingent, not the subject of bona fide disputes as to the liability or amount, unsecured or under secured in the amount of at least USD 16,750. Additionally, the involuntary petition form requires the petitioning creditors to allege either that the debtor is generally not pay its debts as they become due unless they are subject of a bona fide dispute as to liability or amount, or that within 120 days a custodian took charge of less than substantially all of the property of the debtor to enforce a lien.

Commented [H(55): Correct, 1 mark, specifically it does not depend on the occurrence of a future event

Commented [H(56): Correct, 1 mark, the test is whether there is an objective basis in fact or law to dispute the debt

Commented [H(57): Correct, 1 mark

Commented [H(58): Correct, 1/2 mark

Commented [H(59): Correct, 1/2 mark

QUESTION 4 (fact-based application-type question) [15 marks in total]

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Question 4.1 [5 marks]

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Speculation Inc is engaged in day-trading stocks from leased office space with two employees. It funds its trading through a margin loan from its broker, where the shares it purchases are held as collateral. For a while, Speculation Inc was very successful in trading, and the US Department of Justice (DOJ) has announced an investigation into whether its success was due to illegally trading on insider information. More recently, Speculation Inc has had serious trading losses, causing its broker to declare a default on the margin loan. It also has fallen behind on its rent, and been sued by a former employee alleging she was fired due to gender bias.

What would be the effect of a Chapter 11 petition being filed by Speculation Inc on each of the (i) DOJ investigation, (ii) margin loan default; (iii) delinquent lease and (iv) employment discrimination lawsuit?

A Chapter 11 recognition provides innovation to US restructuring as it allows for a worldwide automatic stay of any proceeding against the debtor or its property providing breathing space for a debtor to continue operating in the ordinary course of business and work with various stakeholders to propose a plan of reorganization that will adjust its debts. Under the chapter 11 the debtor in possession has the ability to reject burdensome contracts, sell assets free and clear of liens and pursue claims for recovery of preferential or fraudulent transfers. The effect of a chapter 11 petition would vary based on the stakeholders namely the following:

Commented [H(62): Correct, 1 mark

- 1. While actions are stayed, The US Department of Justice could continue their investigations into Speculation Inc and provided criminal proceedings were commenced this would be the exception to the automatic stay.*
- 2. The Chapter 11 filing would allow Speculation Inc to open negotiations with their broker to develop a plan of reorganization while the automatic stay prevent a potential foreclosure on shares held as collateral.*

Commented [H(63): Correct, 1 mark

Commented [H(64): Incorrect, the margin loan is a securities contract exempt from the automatic stay, so the broker could liquidate the collateral.

3. *Provided an eviction notice has been issued to Speculation Inc the automatic stay would apply allowing Speculation Inc to use in the ordinary course of business. However, under Chapter 11 Speculation Inc can begin negotiations with the landlord on a reorganization plan for the overdue amount. Should they ultimately decide to reject the contract the landlord would have an unsecured pre-petition claim in damages. Should they assume the contract Speculation Inc would need to cure overdue amounts and provide assurance of future performance.*
4. *An automatic stay would apply to the employment discrimination lawsuit from the former employee as it is considered litigation on a pre-petition claim.*

Commented [H(65): Correct, 1 mark, the landlord could not evict (because the lease has not expired) or sue for past-due rent

Commented [H(66): Correct, 1 mark

Question 4.2 [5 marks]

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Stella SA (Stella) is an international cosmetics company incorporated in France, with its headquarters in Paris. Stella's products are made in Italy and shipped to its retail stores in Europe (including England), Asia, and North America. Stella's funding comes from a bank loan and Eurobonds, both of which are governed by English law. Stella's retail sales have suffered due to pandemic-related closures and it is considering options to restructure its debt. One option is to use an English scheme of arrangement with respect to the Eurobonds. Could the English scheme of arrangement be recognized by a US bankruptcy court under Chapter 15, and would such recognition be as a foreign main or non-main proceeding?

Foreign main proceedings are those that are commenced in the debtor's centre of main interests ("COMI"). The location of Stella's headquarters in Paris and their incorporation in France provides sufficient evidence to demonstrate that Stella's COMI is in France where proceedings will be categorized as foreign main. Additionally, proceedings in a jurisdiction other than the debtor's COMI can be recognized as a foreign non-main proceeding only if the debtor had an establishment in the jurisdiction. An established jurisdiction being a place where they carried out non-transitory economic activity prior to a chapter 15 filing. As Stella's assets are housed in retail stores in Europe, England, Asia and North America they would then allow Stella to have qualify as having an establishment in those jurisdictions. The English scheme of arrangement could be recognized by a US bankruptcy court under Chapter 15 and the recognition would be classified as a non-main proceeding.

Commented [H(68): Correct, 1 mark, the connections with other jurisdictions would be unlikely to overcome the presumption in favor of the jurisdiction of incorporation.

Commented [H(69): Correct, 1 mark

Commented [H(70): Correct, 1 mark, the relevant establishment for this analysis is the one in England, where the foreign proceedings are pending.

Commented [H(71): Correct, 1 mark

Question 4.3 [5 marks]

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ToyCo is an American toy company that has created a popular line of folding robot toys called Xblox. The toys are covered by several US patents. Currently, GameMart Inc (GameMart) has a 10-year exclusive license to manufacture Xblox and pays ToyCo monthly royalties. GameMart operates a factory in California that it leases from Land Corp on a longer term lease with seven years to go; the lease prohibits assignment without Land Corp's consent. The Xblox toys are selling well, but GameMart's other

toy lines are doing poorly, so it is considering a Chapter 11 bankruptcy. Answer the following questions:

(i) Is the license to manufacture Xbox an executory contract?

The license to manufacture Xbox is an executory contract as there are material unperformed obligations on both sides such as the ongoing permission to manufacture and receipts of payments of royalties due over the next 10 years with freedom from any suits.

Commented [H(73)]: Correct, 1 mark

(ii) Can GameMart transfer the Xbox license as part of 363 sale without ToyCo's consent? Why or why not?

GameMart cannot transfer the Xbox license as a part of 363 sale without ToyCo's consent as ToyCo's consent is required because substantive non-bankruptcy (trademark/intellectual property licensing law) law provides that a counterparty cannot be compelled to accept performance from a transferee.

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Commented [H(75)]: Correct, 1 mark

(iii) Can GameMart transfer the factory lease as part of 363 sale without Land Corp's consent? Why or why not?

The factory lease is assignable without Land Corp's consent, but still subject to Land Corp's approval of the provision. Counterparty consent is not required when the contract is one to make a loan or other financial accommodation, or where substantive non-bankruptcy law provides that the counterparty cannot be compelled to accept performance from the assignee.

Commented [H(76)]: Correct, 1 mark

Commented [H(77)]: Incorrect, the lease wouldn't fall within this provision. There just needs to be adequate assurance of the transferee's future performance.

* End of Assessment *